FitchRatings

Fitch Affirms Hidrovias' Ratings at 'BB-'; Outlook Stable

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Fitch Ratings has affirmed Hidrovias do Brasil S.A.'s (Hidrovias) Long-Term Foreign Currency (FC) and Local Currency (LC) Issuer Default Ratings (IDRs) at ‘BB-’, and its National Long-Term Rating at 'AA-(bra)'. Fitch has also affirmed Hidrovias International Finance S.a.r.l.'s senior unsecured notes at ‘BB-’ and Hidrovias’ senior unsecured debentures at ‘AA-(bra)’. The Outlook for the corporate ratings is Stable.

Hidrovias' ratings reflect its strong position in the waterway transportation sector in the North and Midwest regions of Brazil and in the Parana-Paraguay river system, where logistics infrastructure is relatively limited. The company's take-or-pay contract business model for most of its revenues partially mitigates demand volatility. The ratings are constrained by moderate leverage, exposure to hydrological risks, crop failures, and client concentration.

Fitch considers that the forecasted capital increase of at least BRL1.2 billion in Oct. 2024 is crucial to Hidrovias to face a sizeable debt maturity in early 2025. This event also allows the issuer to compensate the impact of a weakened operational performance in 2024 on its capital structure. The company faced deteriorated hydrological conditions in its South and North corridors, while the uncertainties regarding the recovery in 2025 remains. Fitch views Hidrovias’ financial flexibility improving after Ultrapar group entered in its shareholder composition.

Key Rating Drivers

Weakened Operating Performance: Hidrovias' expected weak operating performance in 2024 due to low water levels in the South and North Corridors should reflect in lower revenues and EBITDAR generation than previously anticipated. Fitch projects Hidrovias’ EBITDAR and cash flow from operations (CFFO) to contract to BRL618 million and BRL228 million in 2024, from BRL756 million and BRL380 million, in 2023, driven by a 14% volume decline and a 7% tariff reduction. In 2025, EBITDAR and CFFO are expected to improve to BRL799million and BRL476 million, assuming an uncertain scenario of slightly better navigation conditions, allowing total volumes to increase by 6%.

Expansion Capex Leads to Negative FCF: Fitch anticipates Hidrovia should be able to finance expansion projects in its North Corridor without impairing its capital structure. Fitch's projections indicate the company will allocate approximately BRL600 million annually to capex from 2025 to 2027, with BRL385 million per year dedicated to expanding Northern operations. This expansion aims to bolster Hidrovia's footprint in the agricultural and fertilizer transportation markets in Brazil's North region. Free cash flow (FCF) is forecasted to remain negative, totalling BRL436 million from 2024 to 2026, before turning slightly positive in 2027.

Capital Increase Benefits Leverage: Fitch believes Hidrovias' potential capital increase prepares the company to expansion investments over the next two to three years and mitigates the impact of lower operating results in 2024. The base case scenario incorporates an equity inflow of BRL1.2 billion leading to an improvement on the net adjusted debt-to-EBITDAR ratio to 3.9x in 2024 and 3.3x in 2025. These figures compare to 4.4x in 2023 and 5.4x as of June 2024. Hidrovias' ability to enhance operating cash flow and maintain leverage sustainably below 3.5x amid an uncertain hydrological environment are key factors for further positive rating actions.

Challenge to Increase Client Diversification: Hidrovias has portfolio concentration risk, as its main clients are J&F Mineração (a former contract of Vale S.A. [BBB/Stable], COFCO Group and Alumina do Norte do Brasil S.A. [Alunorte]), which Fitch estimates together account for 48%-62% of total EBITDA on historical basis. In recent years, Hidrovias added new clients and sectors to its portfolio, including new service activities in Santos Port, but these additions only account for around 10% of EBITDAR. During 2023, EBITDAR breakdown by corridor was: North (50%), South (45%), Coastal (13%) and Santos (1%) (with holding and others representing 9% of expenses). Approximately 58% and 42% of EBITDA is generated in Brazil and Uruguay/Paraguay, respectively.

Ultrapar Affiliation is Positive: Fitch views Hidrovias' affiliation with the Ultrapar group as credit positive. The company's transition to being controlled by a corporation with a strong credit profile and a long-term strategy is beneficial compared to the former private equity investor. Ultrapar is one of the leading business groups in Brazil, actively engaged in energy and logistics infrastructure. The minimum expected capital injection of BRL600 million from Ultrapar into Hidrovias underscores the shareholder commitment to the issuer's long-term business expansion strategy. This shareholder should enhance Hidrovias' financial flexibility.

Derivation Summary

Hidrovias's has the weakest position in the 'BB' rating category relative to transportation and logistics peers across the region, which are generally rated in the 'BB' to 'BBB' categories. Hidrovias' rating is constrained by its medium-size business scale, hydrological risks and weakest capital structure among Brazilian peers, including MRS Logistica S.A. (LC IDR BBB-/Stable), Rumo S.A. (LC IDR BB+/Stable), and VLI S.A. (AAA[bra]/Stable). Offsetting those factors are Hidrovias' competitive position in the region it operates and the majority of operations being based on take-or-pay contracts that helps to partially mitigate business volatility.

Hidrovias' net adjusted leverage is expected to remain higher than other rated Brazilian peers in the transportation and logistics sector with more mature operations and with higher ratings. Rumo, VLI and MRS Logistica should report net leverage below 2.5x in the next two years, while Hidrovias' ratings incorporate expectations of net adjusted leverage ratio trending to 3.3x by 2025.

Key Assumptions

Fitch's Key Assumptions Within Our Rating Case for the Issuer

-- Volumes to decline 14% in 2024, reflecting declines of 22.4% in North corridor and 25.5% in South Corridor.;

-- Volumes to recover by 5.9% in 2025;

-- Average annual capex of around BRL550 million in 2024–2027, reflecting average annual capex for expansion project of BRL385 million in 2025-2027;

-- Capital increase of BRL1,154 million in the 4Q2024.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Broader client diversification;

-- Net adjusted debt/EBITDAR consistently below 3.5x and total adjusted debt/EBITDAR below 4.0x;

-- Interest coverage consistently above 4.5x;

-- Maintenance of strong liquidity to avoid refinancing risks.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- Failure to conclude the capital increase as expected in the base case scenario;

-- Large debt-funded M&A transactions or entering into a new business in the logistics sector that adversely affect its capital structure on a sustained basis or increase business risk exposure;

-- Net adjusted debt/EBITDAR consistently above 4.5x on a sustained basis;

-- Deterioration of liquidity position, with increasing short- to medium-term refinancing risks.

Liquidity and Debt Structure

Reduced Refinancing Risks: Hidrovias has demonstrated a consistent history of maintaining robust cash balances. The anticipated capital increase is expected to mitigate refinancing risks, thereby providing the company with enhanced financial flexibility as it seeks suitable refinancing options to meet capex needs. Failure to secure the BRL1.2 billion capital increase will elevate refinancing risks as the payment of USD150 million in bonds matures in Jan. 2025. As of June 30, 2024, Hidrovias' cash position stood at BRL830 million, with short-term debt amounting to BRL1.2 billion. Total debt was BRL4.7 billion, comprising international bonds (63%) maturing in 2025 and 2031, local debentures (22%), bank credit notes (11%), and leasing obligations (5%).

Issuer Profile

Hidrovias is an integrated logistics provider focused on waterways logistics services. It has an end-to-end infrastructure, including transhipment, port terminals and a fleet of barges, pusher tugs and cabotage vessels. The company operates in logistics corridors in the northern region of Brazil and in the Paraguay-Paraná river system.

Summary of Financial Adjustments

--Lease expenses were adjusted back to operating income, reducing EBITDA.

--The leasing obligation reported in the balance sheet is considered as debt.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

ESG Considerations

Hidrovias do Brasil S.A. has an ESG Relevance Score of ‘4’ for Exposure to Environmental Impacts due to the effective impact on the company operations due the hydrological risks., which has a negative impact on the credit profile, and is relevant to the rating[s] in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of ‘3’ means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch’s ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Applicable Criteria

Corporate Rating Criteria (pub.03-Nov-2023)(includes rating assumption sensitivity)

National Scale Rating Criteria (pub.22-Dec-2020)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.21-Jun-2024)

Applicable Models

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

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